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No. 90-984

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

KANSAS GAS AND ELECTRIC COMPANY,
Petitioner,

v.

STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS, *et al.*
Respondents.

Petition for a Writ of Certiorari to the Court of Appeals of the State of Kansas

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BRIEF IN OPPOSITION OF RESPONDENT CITIZENS' UTILITY RATEPAYERS BOARD

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QUESTION PRESENTED

Under the Federal Power Act, a dual system of regulation exists. The Federal Energy Regulatory Commission (FERC) regulates most of the wholesale transactions of electric utilities engaged in interstate commerce, and the regulation of retail electric rates is left largely to the states. The question presented by this case is:

> Whether the Kansas Corporation Commission acted within its jurisdictional authority in protecting captive retail ratepayers from some of the detrimental impacts associated with Petitioner's attempts to include additional generating capacity in its retail rates.

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Respondent Citizens' Utility Ratepayers Board (CURB)[1] respectfully prays the Court deny the Petition for a Writ of Certiorari requested by the Kansas Gas and Electric Company (KG&E) in this case.

STATEMENT OF THE CASE

This brief will describe in some detail the factual and

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[1] CURB is a state agency composed of five volunteer consumer advocate members. Through its attorney, the state's Consumer Counsel, CURB is authorized by state statute to represent the interests of residential and small commercial ratepayers. Kan. Stat. Ann. 66-1222 et seq. (1989).

procedural background of this case. Such detailed background is necessary because the agency decision being contested here was taken in response to a unique set of facts and a unique procedural history. In recognizing the fact-bound nature of that action, the Kansas Corporation Commission (KCC) stated, "It must be noted that this adjustment, which may be considered novel in terms of this Commission, is being made because of the novel circumstances in this docket." (KG&E App. 57a-58a). The Court may notice that, in contrast to this brief, KG&E's petition provides relatively little insight into the convoluted facts and procedural history of this particular case. This is because the nature of the case below, the issue being contested, and the KCC's treatment of that issue are, in reality, very different than portrayed in KG&E's petition.

KG&E's petition relates, at length, the development of federal jurisdiction concerning interstate wholesale power transactions. It paints a picture of a struggle for jurisdictional authority between federal and state regulators, and it argues that the Court must consider this case in order to help resolve that struggle. CURB does not disagree that the dual regulation of electric utilities creates tensions that the courts must address from time to time. However, this case, because of its unique facts and procedural background, is not the case on which to base the extension of federal jurisdictional authority requested by KG&E.

FACTUAL BACKGROUND

In 1985, after months of technical and public hearings, the KCC entered its order in the Wolf Creek rate case -- the case in which KG&E sought to place in rate base its share of the $3.05 billion Wolf Creek Nuclear Generating Station. In that order, in addition to authorizing

a phased-in rate increase, the KCC deemed one-half (46 megawatts [MW]) of the retired Ripley Steam Electric Station (Ripley) available for use until such time as the retirement was judged to be prudent by the Commission. The KCC deferred its decision regarding the rate implications of the Ripley retirement. *Re Wolf Creek Nuclear Generating Facility*, 70 P.U.R. 4th 475, 514 (Kan.Corp.Comm. 1985).

The Kansas Supreme Court affirmed that order in *Kansas Gas & Electric Co. v. Kansas Corporation Comm'n*, 239 Kan. 483, 720 P.2d 1063 (1986). KG&E appealed to this Court, which noted probable jurisdiction. *Kansas Gas & Elec. Co. v. State Corp. Comm'n of Kansas*, 479 U.S. 1082 (1987). The appeal subsequently was dismissed as moot. 481 U.S. 1044 (1987).

The KCC approved the retirement of Ripley by an order dated March 19, 1987. A few days earlier, by an order dated March 11, 1987, the Commission delayed a scheduled Wolf Creek increase from September 27, 1987 to January 1, 1989 and directed "that the revenue impact resulting from the Ripley retirement be added to the third increase and become effective on a permanent basis on January 1, 1989, with one condition." (KG&E App. 134a). That condition was that KG&E demonstrate that its "need for Wolf Creek, whether from peak growth or reduced overall generating capability, will have grown by 41 MW from 1986 to 1988 so as to justify adding the incremental revenue impact to the January 1, 1989, increase." (Id., 134a-135a). The amount of the "revenue impact" was not discussed in the order. The Commission also left the door open for further review of the future rate increase:

> However, we note by this action that we have not foreclosed the possibility of further challenge to the third and fourth increases. Nor is our action incon-

> sistent with the possibility that at some point after the increases become effective that it would be appropriate to examine the reasonableness of KG&E's earnings. . . . If no earlier action is necessary, any customer of KG&E, as well as the Commission staff, is always free to file a complaint alleging that KG&E's rates are unreasonable. (Id., 136a-137a).

The order further stated, "Of course, the Commission also continues to have the right to reexamine all elements of KG&E's revenue requirements should it appear that its earnings or rates are unreasonably high." (Id., 150a).

In a July 15, 1988, order, the revenue impact associated with the Ripley retirement was referred to by the Commission majority as "an opportunity (for KG&E) to demonstrate its need for an additional increase." Although the amount of the increase was not specified, one could infer from the order that the increase would amount to $14.4 million. This was the first time that the magnitude of the possible increase had been publicly disclosed. No hearings were held in the docket that produced that order.

The Commission conducted a hearing on December 21, 1988, to provide KG&E with an opportunity to prove that its need for additional generating capacity had increased by 41 MW from 1986 through 1988. The scope of that hearing was "strictly limited" to that issue by the Commission. Accordingly, neither in the prefiled testimony of the witnesses, nor during the hearing itself, was there any discussion of the rate increase that would occur if the 41 MW were to be included in rates.

CURB intervened in the case. Because of the short procedural schedule and the narrow scope of the hearing, as established by the Commission, CURB also moved the Commission to schedule further hearings to address numerous legal and factual issues raised by CURB and, in

the meantime, to grant KG&E its $14.4 million rate increase only on an interim basis, subject to refund.

On December 30, 1988, the Commission majority granted CURB's motion, and the $14.4 million increase was approved on an interim basis, subject to refund,[2] pending a KCC staff audit and further hearings. A $14.6 million increase, which represented the final Wolf Creek increase, was not contested and was granted to KG&E on a permanent basis by the order.

The KCC Proceedings at Issue

At the conclusion of its audit, the KCC staff filed testimony recommending that current rate levels (which included the recently-authorized $14.4 million rate increase) remain in effect. KG&E filed testimony making the same recommendation. CURB, on the other hand, filed testimony recommending numerous adjustments to KG&E's retail revenue requirement that, if adopted in their entirety, would result in a $32.9 million rate decrease. Two of the CURB adjustments that were adopted by the KCC were based upon KG&E's attempts to justify its need for additional generating capacity in its retail rate base. One of those two adjustments is the subject matter of KG&E's petition to this Court and will be discussed in detail later in this brief.

The KCC conducted both evidentiary hearings and public hearings, which provided an opportunity for input from KG&E retail ratepayers. On February 13, 1990, the KCC reduced KG&E's existing rate levels by about $8.7 million. That reduction incorporated the CURB-proposed adjustment related to the OMPA sale.

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[2] That part of the December 30, 1988 KCC order that designated the rate increase interim and subject to refund was later reversed by the Kansas Court of Appeals in an unpublished opinion.

The Kansas Court of Appeals Decision

KG&E appealed the KCC order to the Kansas Court of Appeals on April 2, 1990, arguing that the KCC had erred in adopting numerous adjustments proposed by its staff and by CURB. With regard to the adjustment related to the OMPA sale, KG&E argued that, under the Supremacy Clause, the KCC was preempted from considering the OMPA sale because the rate for the sale had been found to be reasonable by FERC. KG&E based its argument on the cases of *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953 (1986) and *Mississippi Power v. Miss. Ex Rel. Moore*, 487 U.S. 354 (1988).

The Kansas Court of Appeals, with one minor exception, affirmed all aspects of the KCC's order in an unpublished opinion dated June 29, 1990. It refused to extend the *Nantahala Power and Light Co.* and *Mississippi Power* holdings to the unique facts of this case. KG&E petitioned the Kansas Supreme Court to review the Kansas Court of Appeals decision. Again, KG&E raised numerous alleged points of error, one of which was the adjustment related to the OMPA sale. The Kansas Supreme Court denied KG&E's petition on September 20, 1990.

REASONS FOR DENYING PETITIONER'S WRIT

I. THIS CASE DOES NOT INVOLVE A CONFLICT BETWEEN FEDERAL AND STATE AUTHORITY REGARDING A WHOLESALE POWER TRANSACTION

As previously described at page three of this brief, the KCC's precondition for allowing the final 41 MW of Wolf Creek into KG&E's rate base was a showing by the Company that a "need" for that additional capacity had developed between 1986 and 1988. That "need" could result from "peak growth or reduced overall generating capability." (KG&E App. 134a-135a). The Commission, in December, 1988, found that KG&E had made a sufficient showing of compliance with the 41 MW precondition. However, the Commission also expressed concern about KG&E's current rates. Therefore, it made the rate increase interim and subject to refund to allow the KCC staff and CURB to investigate more fully the issues surrounding KG&E's need for an additional rate increase.

One of the areas CURB investigated more fully was the manner in which KG&E met the 41 MW precondition. As stated above, the KCC determined that KG&E could meet this precondition through "peak growth or reduced overall generating capability."

It was immediately apparent that KG&E had not met the precondition in terms of reduced overall generating capability, which declined by only four MW between 1986 and 1988. Therefore, KG&E chose to emphasize the decrease in *system* capability as opposed to *generating* capability.[3] KG&E's *system* capability, as opposed to *generating* capability, decreased by 62 MW between 1986 and 1988. The majority of that decrease is attributable

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[3] System capability is generating capability plus or minus the net effect of capacity purchases and sales.

to the 41.2 MW, 15 year, sale of capacity to OMPA. As already stated, the capacity that was sold was some of KG&E's least expensive.

The sale became an issue in this case because, as stated above, KG&E chose to rely upon it in establishing the Company's "need" to move the final 41 MW of Wolf Creek into its Kansas retail rate base. CURB considered it inequitable for KG&E to sell some of its cheapest power out-of-state and then to use that sale as a justification for placing more of its most expensive generating capacity in Kansas retail rates.

CURB's adjustment to deal with this inequity was conceptually simple. Its premise was that Kansas retail ratepayers should not have to pay the difference between the revenues received from the sale and the costs associated with an identical share of Wolf Creek. That difference amounted to $13.5 million.

The KCC adopted CURB's adjustment, finding as follows:

> It must be noted that this adjustment, which may be considered novel in terms of this Commission, is being made because of the novel circumstances in this docket. This is not a simple sale of excess power by one utility to another. It is a case of one utility selling its cheapest and lowest cost capacity to another, while including its highest cost capacity in rates paid by its jurisdictional, captive ratepayers. Even more importantly, this sale was used as justification for including that high-cost capacity in rates and the resulting interim rate increase at issue in this docket. KG&E met part of the condition precedent established by this Commission for including the revenue impact of the Ripley retirement with KG&E's January 1, 1989, rate increase by increasing its capacity sales by 43 MW between 1986 and 1988.

> Included in those 43 MW is the 41.2 MW of capacity committed for 15 years to OMPA. This capacity sale supported KG&E's position that its overall system generating capability had been reduced sufficiently to justify including the revenue impact of the Ripley retirement with KG&E's January 1, 1989, rate increase. (Transcript of December 21, 1988, hearing in this docket, p. 19) (KG&E App. 57a-58a).

KG&E's entire argument to this Court regarding the OMPA-related adjustment is misdirected. The KCC's action had no effect on the contract between KG&E and OMPA. The contract rate was not reviewed and was not even an issue in this case. The sale itself would not have been an issue had not KG&E chosen to make it one by relying upon the sale to justify placing an identical amount of Wolf Creek into its Kansas retail rate base. Thus, in this case, the KCC was not reviewing the propriety of the rate or the terms of the contract. It was not even reviewing the propriety of KG&E entering into the contract. What the KCC did do was protect captive Kansas customers from the detrimental impacts of placing additional Wolf Creek capacity into retail rates. The OMPA sale simply provided a basis for calculating those detrimental impacts, which was entirely appropriate considering KG&E's reliance on the sale as a justification for increasing its Kansas retail rates. As the Kansas Court of Appeals found:

> FERC regulates the sale of wholesale power. The KCC's actions in imputing revenue at Wolf Creek rates does not affect the FERC-filed rates. Since the KCC is not regulating the same activity, it seems there can be no conflict, and the Supremacy Clause does not prohibit the KCC's actions. (KG&E App. 19a).

II. THE KANSAS CORPORATION COMMISSION ACTED WITHIN ITS JURISDICTIONAL AUTHORITY IN PROTECTING CAPTIVE RETAIL RATEPAYERS FROM SOME OF THE DETRIMENTAL IMPACTS ASSOCIATED WITH PETITIONER'S ATTEMPTS TO INCLUDE ADDITIONAL GENERATING CAPACITY IN ITS RETAIL RATES

It is undisputed that the states have a substantial, legitimate interest in regulating intrastate rates. *New Orleans Pub. Serv. v. New Orleans*, 491 U.S. ___, ___, 105 L.Ed.2d 298, 315 (1989). Also see *Central Hudson Gas & Electric Corp. v. Public Service Comm'n of New York*, 447 U.S. 557, 569 (1980). In fact, "the regulation of utilities is one of the most important functions traditionally associated with the police power of the States." *Arkansas Elec. Coop. v. Ark. Public Serv. Comm'n*, 461 U.S. 375, 377 (1983), citing *Munn v. Illinois*, 94 U.S. 113 (1877). In the Federal Power Act (FPA), Congress mandated federal regulation of electricity transmitted or sold at wholesale in interstate commerce. Such federal regulation, however, does not extend to areas traditionally regulated by the states. 16 U.S.C. § 824(a) and (b). In reviewing of the legislative history of the Act, this Court has noted that the bill was enacted to fill a regulatory gap -- to supplement state regulation, not to impair or diminish any existing state regulatory powers. See *Connecticut L. & P. Co. v. Federal Power Com'n*, 324 U.S. 515, 525-527 (1945).

In its petition, KG&E alleges that the KCC's action violates the filed rate doctrine and analogizes this case to *Nantahala Power and Light Co.* and to *Mississippi Power*. The filed rate doctrine was established by this Court in *Montana-Dakota Utilities Co. v. Northwestern*

Public Service Company, 341 U.S. 246 (1951). Essentially, the doctrine is that the rate filed with FERC is the only legitimate rate. The purchaser's right to a reasonable wholesale rate is the right to the FERC-approved rate. Except for a narrow review of FERC orders, the court can assure no right to a different rate on the ground that, in its opinion, another rate is more reasonable. In *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981), the doctrine was transformed into a rule of preemption under which state courts must recognize the inviolability of wholesale rates on file with or approved by FERC. The parameters of the doctrine were examined further in *Nantahala Power and Light Co.* and *Mississippi Power*.

In *Nantahala Power and Light Co.*, FERC had determined that a certain allocation of purchased power between two affiliated companies was just and reasonable. The state commission, however, found the allocation to be unjust and unreasonable and adopted another allocation to replace it. This Court overturned the state commission order, finding that FERC had jurisdiction to allocate power between affiliates and that a FERC-approved allocation must be followed by the state regulatory body. Because the state commission had adopted a different allocation, the utility had experienced "trapped costs," which are prohibited. That is, the utility was incurring FERC-mandated purchased power costs at a FERC-approved rate that the Company could not recover through retail rates by virtue of a state commission order that contradicted FERC's allocation. *Id.*, 476 U.S. at 970-973. Thus, in that case, the filed rate doctrine was used to uphold FERC's authority to allocate power among affiliated utilities and to prevent such allocations from being altered by the states.

In *Mississippi Power*, the Court dealt with the same issue -- a power allocation (in the form of a pooling agree-

ment) between affiliated companies. The Court again upheld FERC's preemptive jurisdiction to allocate power among affiliates, relying on its decision in *Nantahala Power and Light Co.* As the Court stated, "The facts of this case and *Nantahala* are not distinguishable in any way that has relevance to the operation of the principles stated above." *Mississippi Power*, 487 U.S. at 372.

The Kansas Court of Appeals accurately presented the relevant facts and the holdings of *Nantahala Power and Light Co.* and *Mississippi Power* in its opinion (KG&E App. 17a-18a). It declined to extend those holdings to the facts of this case, stating:

> In the instant case, KG&E is not the buyer of the wholesale power, but the seller. In *Nantahala* and *Mississippi Power*, the affected utility was the buyer of the wholesale power. The wholesale rates paid by OMPA were not affected and OMPA was not prohibited from recovering the FERC-approved rates. The cases simply do not address the effect of state regulation on the seller of the wholesale power that recovers the FERC-filed rate. (KG&E App. 18a).

The Kansas Court of Appeals was correct in holding that *Nantahala Power and Light Co.* and *Mississippi Power* are not directly applicable to this case because of its unique evidentiary and procedural facts. The basis of those holdings -- trapped costs resulting from a FERC-approved rate[4] -- is not present here.[5] Those cases deal

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[4] *Nantahala Power and Light Co.*, 476 U.S. at 970.

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[5] Although KG&E attempts to argue that it has experienced trapped costs (see p. 19, note 17 of KG&E's petition) nothing could be further from the truth. KG&E's retail revenue requirement was reduced below the level considered appropriate by KG&E. The adjustment

with the pass-through of FERC-mandated costs -- not with FERC-approved sales that create revenue. Those cases would be directly applicable here if KG&E had bought power from OMPA, and the KCC had found the FERC-approved rate to be unreasonable, and on that basis had refused to allow KG&E to recover that cost through retail rates. However, in trying to extend those holdings to this situation, KG&E is faced with making an argument that is facially invalid -- i.e. that because FERC has approved the amount of additional revenue KG&E is receiving from the OMPA sale, the KCC is preempted from reviewing KG&E's attempts to place additional capacity in its retail rate base and to raise its retail rates.

This is not to say, of course, that FERC jurisdiction does not extend to sellers of interstate wholesale electricity. As the Kansas Court of Appeals correctly noted, however, the KCC is not regulating the same activity that FERC is regulating. (KG&E App. 19a). FERC simply determined that the rate at which the capacity was sold to OMPA was just and reasonable, and that is all that FERC determined. The KCC did not even review the rate, let alone question it. It simply was not an issue in the case. Neither did the KCC question the propriety of the sale. Instead, the KCC reviewed all elements of KG&E's retail cost of service, including the cost associated with adding additional Wolf Creek capacity to retail rate base. KG&E's partial justification for this increased cost was that the Company had less capacity available to

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at issue, however, was based upon the costs of the Wolf Creek capacity being brought into retail rate base -- not the cost of the capacity sold to OMPA. The revenue received from the OMPA sale was used as an offset to the Wolf Creek costs. KG&E, however, was benefitted -- not harmed -- by that offset, because it reduced the amount of the adjustment.

meet its retail demand because of the OMPA sale. The revenue from the OMPA sale was more than offset by the additional cost of moving additional, replacement Wolf Creek capacity into retail rate base. The KCC-adopted adjustment allowed KG&E to move the Wolf Creek capacity into retail rate base, but protected retail ratepayers from those added costs. In *Nantahala Power and Light Co.*, this Court recognized the appropriateness of this type of state regulatory scrutiny. *Id.*, 476 U.S. at 967-968.

Not mentioned by KG&E in its petition is a decision by the Court that is helpful in this case because it clarifies the limits of the holdings in *Nantahala Power and Light Co.* and *Mississippi Power.* In *New Orleans Pub. Serv.* this Court considered whether federal courts should abstain from deciding a preemption challenge to a Louisiana ratemaking order. In determining whether abstention was appropriate, the Court was required to decide whether a valid claim of preemption existed. Abstention by a federal court is not an issue in this case. The Court's opinion is instructive, however, because it reviews types of state action that would be preempted. In concluding that there was no colorable claim of preemption in that case, the Court stated:

> The Council has not sought directly to regulate interstate wholesale rates; nor has it questioned the validity of the FERC-prescribed allocation of power within the Grand Gulf system, or the FERC-prescribed wholesale rates; nor has it reexamined the prudence of NOPSI's agreement to participate in Grand Gulf 1 in the first place. Rather, Council maintains that it has examined the prudence of NOPSI's failure, after the risks of nuclear power became apparent, to diversify its supply portfolio, and that finding that failure

> negligent, it has taken the normal ratemaking step of making NOPSI's shareholders rather than the ratepayers bear the consequences. Nothing in this is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the case law applying it. *Id.*, 491 U.S. at ___, 105 L.Ed.2d at 316.

The KCC's action in this case does not fall within any of the prohibited state activities listed by the Court in *New Orleans Pub. Serv.* Also apropos to this case is the Court's rejection in that case of the utility's argument "that under the particular facts of the present case its FERC-allocated wholesale costs are not a proper subject for such (state) proceedings." KG&E has made the identical argument in this case with regard to the revenues received from the OMPA sale. In rejecting the utility's argument in *New Orleans Pub. Serv.*, the Court said "this argument of NOPSI ultimately reduces once again to insistence upon too narrow an analytical focus." *Id.*, 491 U.S. at ___, 105 L.Ed.2d at 315-316.

CONCLUSION

For the above and foregoing reasons, the Court should deny KG&E's petition for a writ of certiorari.

Respectfully submitted,

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